Sense 87

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Takeovers:

Are they restructuring Corporate America?

A view from the Top

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John C. Whitehead 3

Andrew C. Sigler 7

John F. McGillicuddy 11

Carl C. Icahn 15

We have asked John C. Whitehead, Andrew Sigler, John F. McGillicuddy, and Carl C. Icahn to express their views on the subject of corporate restructuring for this, our 87th issue of Sense. *We believe you will find their views unusually illuminating—their perspectives stimulating and refreshing.*

Within the current business climate, certain traditional attitudes concerning ownership and control of corporations are being seriously challenged. A reshaping of American industry is clearly under way.

Takeovers and mergers can be a healthy part of everyday business—but some takeovers are a serious threat to both management and investors. We don't see America prospering from hostile takeovers. We see America prospering from hard working, intelligent, competitive, and creative management.

However the challenge is met—be it by legislation or new corporate disciplines—today's corporate leaders are of necessity developing inventive strategies to deal with this new reality.

Although frequently overlooked, one of these disciplines is "perception." Good management should recognize the importance of how the company is perceived by the financial community and by the public.

Perception is our expertise. We believe it is too serious an issue for management to ignore. We believe it is crucial for management to develop fully this corporate discipline to assist them, not only in achieving goals, but also in communicating those goals to their important audiences.

We trust that after reading Sense 87 *your appreciation for the importance of communicating corporate strategy will be enhanced. We look forward to your comments.*

Walter P. Margulies *Clive Chajet*

John C. Whitehead

Former Senior Partner
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"The corporate executive who finds his stock undervalued is, of course, in a vulnerable position. What he must do is operate his company in such a way that investors will perceive the greater values that are in the company."

Is the takeover movement we're seeing a passing fad or part of a basic restructuring of the American corporate scene?

The merger movement is an important part of what's going on in corporate America, and it's certainly more than a passing fad. But I think we must keep it in perspective. Many of the mergers are big and headline-catching, but the great majority of companies are not involved in mergers and go about doing their jobs year after year without acquiring and without being acquired.

As long as people feel that the market has substantially undervalued companies, there will be continuing efforts to acquire them. But there may be something more basic at work. I believe we're going through a period in which managements are refocusing their objectives. They are concentrating more on the core of their businesses and less on the peripheral parts. We're in an age of concentrating rather than diversification. We're seeing the other side of the coin after a long period when companies felt they had to get into other businesses in order to protect themselves against what were the perceived problems and disadvantages of their core businesses. In the last several years, we're seeing a reversal of that. Companies are concentrating on the things they do best and are spinning off their fringe businesses at which they haven't done particularly well.

Is this a process of deconglomeratizing?

It is, and I consider this a very healthy thing. It's much healthier for a company to concentrate on what it knows best and not try to spend stockholders' money getting into other businesses.

Isn't that an implied criticism of the conglomerate movement of the 1960's?

It is indeed. As I look back on that period, it seems to me that it has not been very successful. I think more acquisitions that companies have made have been unsuccessful than have been successful, as one looks back on that movement. So I welcome what's been going on, and I think it's better for the economy to have each company concentrate on the relatively small number of things it does really well, and to leave to someone else the other things that are on the fringes.

Why has it been the policy of Goldman, Sachs not to participate in hostile takeovers?

The firm has not managed unfriendly tender offers, and the basic reason was that we didn't think unfriendly offers were either good strategy or good tactics for the acquiring company. The statistics indicate that the company that initiates an unfriendly tender offer rarely ends up being the ultimate acquirer because the company that is attacked usually seeks out a more friendly partner and ends up merging with that company instead of the original attacker. The original attacker, by adopting unfriendly tactics, decreases the chances of success.

Furthermore, if the unfriendly attacker should be successful, he ends up acquiring the company with a management that is angry and will be very unlikely to be cooperative and therefore may not be successful in working for the acquiring company. So that what he finally succeeds in taking over may not be at all what appealed to him initially.

What about the argument that the target company may not be well-managed and that the objective is to replace that management?

Those kind of situations, while they do exist, make up only a small part of the merger movement. Basically, the companies that are attractive to acquirers are well-managed companies, not poorly managed ones.

Are you concerned by this takeover trend?

I am disturbed because it is diverting the time and energy of corporate managements. The top managements of nearly every company I know are worried about either who they're going to take over or whether they're going to be taken over themselves. That is not a healthy thing. Managements should be spending their time on running their businesses and not on being involved in corporate warfare.

The difficulty is how to stop it without over-reacting. How to continue to permit so-called desirable mergers, those that throw out inefficient managements, and still not encourage the undesirable mergers that are just a function of corporate ambition and greed. That's a very difficult problem.

Are you in favor of legislation or more regulation?

No, I'm not. I would like to feel that the private sector can solve its own problems. I think that the devices and restrictions that companies are placing on takeovers will ultimately create a new balance be-

tween the raider and the defender. I speak of staggered boards, efforts to stop two-stage tender offers, poison pills, preferred stock and other methods that are instituted by a vote of the stockholders. So in time, stockholders and companies will come up with new structures that will provide the right balance between the attacker and the defender.

Is Wall Street responsible for the undervaluation of the stocks of so many companies?

Our power is not that great. We in Wall Street are middlemen between the issuers of securities and investors in securities and we don't determine the level of the markets. Those are determined in the free market by buyers and sellers.

From the point of view of the corporate executive, what's the significance of undervaluation and what can be done about it?

The corporate executive who finds his stock undervalued is, of course, in a vulnerable position. What he must do is operate his company in such a way that investors will perceive the greater values that are in the company. I don't know of a simple panacea for the problem of an undervalued company.

How would you advise a company to deal with this problem?

I would advise them to take a look at the mix of their assets, see whether there are some assets that, in the interests of their stockholders, should appropriately be sold off at higher prices than they are carried on the books. I would look at the alternatives of shrinking the capitalization of the asset base, the divesting of undervalued assets. Many companies have been finding that real estate on their books is not necessary to own and can be sold for very high prices to real estate investors. Many companies have found they're in businesses that are not providing a sufficient return and that can and should be sold to others who can operate them more efficiently. Many companies are finding that marginal operations can no longer be justified and should be closed down. There are a whole variety of ways in which management can deal with undervaluation.

What about corporate image?

Translated into financial terms, what determines which companies sell at six times earnings and which companies sell at sixteen times earnings? It's a complex of factors. But the principal ingredient is the perception of investors as to the quality of management, the quality of the people in the company. That is reflected in the record the company has established over a period of years. But it is also reflected in a lot of intangible factors that have to do with the perceived quality of the people and the quality of the management group, the quality of the company's products, and in a general perception of how the company comes across.

Is the quality of management really that significant?

Absolutely. Management is everything. Assets don't mean much on a balance sheet without management to manage those assets. Assets become dead very quickly without good managements to manage them.

Andrew C. Sigler

Chairman and Chief
Executive Officer
Champion International Corporation

Chairman of the Business
Roundtable's Task Force on
Corporate Responsibility

"I think business has done a rotten job of describing what we are, how we are and how the system works...I think our system is uniquely good, but it's fragile."

Why are you opposed to hostile takeovers?

I don't like what corporate raiders are doing. I will admit they are very smart and are making a great deal of money, but they are doing so at the expense of the economy at large. Their activities have led to a number of unacceptable abuses including the creation of a speculative climate that encourages professional traders to invest in a company—not to see it grow and prosper, but to make sure it gets sold.

The idea these days is to get a company "into play," even if the initial player has no intention of making a serious offer. At this point, the arbitrageurs jump in, hoping to make a killing if and when the company is taken over. The shareholder base is thus changed dramatically with substantial amounts of stock now in the hands of people with no real interest in the long-term future of the company. And the company finds itself on the selling block, whether it likes it or not.

This does not create any new wealth. It only shifts ownership and replaces equity with debt, thus loading a company with a burden that weakens it for the future. By taking equity out of our economic system, the rash of hostile takeovers we're seeing is hurting the country.

Isn't the takeover game part of the free market system?

Yes, it is, and that's something that should be preserved, but because the system is worth saving, any threat to it should be addressed. Business leaders, by and large, have been slow to understand the threat and are reluctant to speak out against it. The Business Roundtable, which represents 200 major corporations, has recently issued a statement of principles on hostile takeover abuses. The statement points out that Congress is considering proposals to deal with the hostile takeover phenomenon and it urges the business community to become involved in the debate. The important thing is to get the debate going so that ideas can be developed and shaped.

What makes the current rash of takeover attempts possible at this time?

Two main factors. First, stock prices are sharply lower than asset values for many companies, especially those in the natural resource area. But that's not even new. During the course of a business cycle, a company spends most of its time undervalued. Price-earnings ratios rose too high in the 1960's and now they've fallen too low. Second, there is a huge

pool of investment money available to fund such efforts. The strong dollar has attracted large amounts of foreign money to the United States. And even more important is the fact that pension funds have now amassed the incredible sum of more than $1.5 trillion dollars, nearly all of it invested by professional fund managers. Those managers have no economic goal or objective other than to outperform one another and make a return sufficient to enable them to retain the management of those funds. Pension funds control some 60 percent of the shares of New York Stock Exchange listed companies.

How do hostile takeovers affect the operations of the companies involved?

They disrupt operations by encouraging management to spend their time on defensive moves and to concentrate on short-term results to the detriment of long-term growth and development. They also create concern among employees and managers alike who are worried about the possible loss of jobs, pension rights and other benefits.

What about the impact of a successful takeover?

Since so much of the equity is sucked out, the company is left with a heavy debt burden. That means it usually can't expand, can't build, can't do anything except pay off its debt service. And the acquisition may also largely be financed by the liquidation of assets to reduce the debt.

What's wrong with selling off assets?

One thing that we've learned to do very well in this country is to run big companies, particularly in industries that need the advantages of scale and require huge outlays for plant and equipment. And some of these investments in plant and equipment don't pay off for a number of years. If threats of being taken over disrupt programs of long-term investment, they will harm the competitive position of the companies and industries involved—and ultimately the United States.

What about corporate image?

I think business has done a rotten job of describing what we are, how we are, why we are, and how the system works. We tend to hide behind our lawyers and our public affairs people, who don't say very much, and I think we've done a terrible job in promoting the system. I think our system is uniquely good, but it's fragile.

Do you think some of that fragility is being evidenced in this takeover business?

I think so. People can't believe how a company can get tied up in knots dealing with this. It can become helpless. They can't imagine a company falling apart. I think we've done a terrible job on image and we have to do a lot better.

Critics have said that the takeover movement helps get rid of entrenched and inefficient management.

With exceptions of course, I think that the management of American corporations consists of dedicated, bright people who have worked hard all their lives. It's management that makes the decisions and management that makes the difference. And I think most boards of directors of major companies are able and willing to weed out any deadwood that is found to exist. We should never lose sight of the fact that a corporation is a lot more than just a collection of assets. Its main strength is its people.

John F. McGillicuddy

Chairman and Chief Executive Officer Manufacturers Hanover Trust Company

"In the final analysis, what a company can do to reduce its vulnerability to a takeover revolves around the company's record—and what the market perceives that record to be."

Are you concerned by the fundamental restructuring of American business that now seems to be underway?

If we look at what is happening in an essentially voluntary way, I see it as very positive—the sizing down of the steel industry, for example, and the retooling and revitalization of the auto industry, which has enjoyed record profits at sales levels that in former years wouldn't have come close to providing those yields. So the reshaping of American industry can be a very positive development that should make us more competitive in the international arena on an ongoing basis.

At the same time, people are coming to the conclusion that the whole is substantially smaller than the sum of the parts. That kind of circumstance is a market reflection—and let's not forget that the markets have made this country what it is today—and that can bring a market reaction, sometimes in a hostile form, as the market fails to put a full valuation on a company's assets. What we're really seeing here is a recycling of capital. And that's healthy. Companies themselves are recasting their character voluntarily in a variety of ways. It's important to note that there have been a lot of divestitures by companies that have not been under attack.

Are there any lessons to be learned from the dismantling of conglomerates that is now going on?

One thing we have learned is that there is a management discipline that often is quite different from one industry to another. Maintaining management control over a multitude of industries is quite different than managing within one industry even though the aggregates may be the same. It's much easier to run a massive, three-product company than a company half that size that has fifty different entities.

Back in the days of the acquisition surge of the Sixties, the idea was to bring together all these different companies and achieve tremendous savings by central staffs for financing, personnel, purchasing, etc. And that did work for a while. Then, all of a sudden, they began to suffer the pangs of a lack of entrepreneurial spirit within their different components. This affected savings first and then ran downhill after that.

We've probably seen it more dramatically than anywhere else in some of the leveraged buy outs; where you take people and let them run their own flag up the pole and the next thing you know they're like Japanese companies, they're out there singing the corporate song, and all of a sudden, overheads that were never attacked before begin to disappear. It's not

only the incentive of ownership; it's the incentive of being a true manager, where your decisions are, in effect, the final decisions.

The single biggest challenge any large corporation faces is trying to create the excitement of an entrepreneurial atmosphere within their own giant framework. It's what we're trying to do here. You have to give your managers the feeling they're managing the business. They don't want to be little cogs at the far end of a massive piece of machinery. Notwithstanding the fact that they are part of a larger organization, they want to feel that they have the ability to exercise a certain amount of independence, judgement and management style and be responsible for results.

Is there a people element involved in the wave of corporate restructuring?

That's a problem. There are dislocative results of takeovers and divestitures. Sometimes employees and managers get the idea that they're commodities to be bought, sold and traded. It gets back to the fact that large organizations must create an entrepreneurial spirit within their own organizations. There's also no doubt that, in a very large measure, greater productivity is achieved by getting people at even the lowest elements of your organization to believe that they're important to you and that they are part of your team.

Is the takeover movement making American companies more short-term oriented?

That's a possibility, but I don't think it's an over-riding consideration because you can't go down that trail terribly long before you run out of steam. Personally, I think that the single greatest pleasure in maximizing earnings comes from the media. Take a look at the year-end results reported by most publications. They really talk about the fourth quarter, making the year as a whole almost redundant. The news is short-term oriented. It's a sign of the times we live in. We've got to live for today. People don't get too excited about what's going to happen five years from now. They want to know what's going to happen five minutes from now.

Is that part of the problem of undervaluation of stocks?

We have a market that's very short-term in its outlook. I think a marketplace that is dominated by short-term considerations doesn't necessarily ascribe values to things of substance, such as sure and steady earnings power over longer periods of time.

How can managements cope with that?

It's easy to be critical and say that corporate management is not getting its message across to the marketplace. I'm sure we're selling for less than we should be, and I would accept the criticism. On the other hand, I would also say that the marketplace really doesn't want to listen. I don't think people can say that corporate management hasn't devoted enough time and attention to the marketplace. There are much more sophisticated techniques now available to impress both institutional and individual investors.

In the final analysis, what a company can do to reduce its vulnerability to a takeover revolves around that company's record—and what the market perceives that record to be. That's very important because once the takeover ball starts rolling, it's very difficult to stop. Nobody can build a perfect defense, but from the shareholder's point of view, there shouldn't be a perfect defense. You can't lose sight of the fact that the shareholder has the right to withdraw from ownership just as he has the privilege of becoming an owner. We may not like some of the practices, but they are a part of our market, and a free market is eminently better than a controlled one.

Would a period of substantially lower interest rates resulting from a meaningful cut in the federal budget deficit have a significant impact on the economy and the valuation of stock?

I think a lower interest rate environment would turn the remainder of the 1980's into a bonanza era in the United States. We have achieved more in terms of the restructuring process on the industrial level. We have revolutionized our financial structure in many ways, and there's more to come. We have a young segment of our society eager and hungry to be part of the process. There's a great spirit in this country, and I honestly feel that if we can get interest rates under control, then we're going to be able to do a lot of the things that America isn't capable of getting done right now because of the handcuffs that exist. And it would have a tremendous impact on the stock market.

Carl C. Icahn

Chairman and Chief Executive Officer
Icahn & Company

"There are a great many companies that are undervalued in the marketplace today...The stock market—which is the best capital-raising mechanism modern man has invented in an incentive type of society such as ours—is telling us that there's a barrier between the real value of these companies and their market value."

You are a major player in the takeover wave now sweeping through the corporate world. What are the reasons for this development?

Basically, because there are a great many companies that are undervalued in the marketplace today. The major reason for this is that many corporations in America are very badly managed. The stock market—which is the best capital-raising mechanism modern man has invented in an incentive type of society such as ours—is telling us that there's a barrier between the real value of these companies and their market value. What stands between these two values is management and the fact that you can't get rid of poor management. Our political system works in this country because we have true democracy. Corporate democracy doesn't work because shareholders don't have a true vote. When someone buys a share of stock, he thinks he has a vote. He believes that if management is bad, he has the right to replace it. But more and more companies want to take rights away from shareholders because their managements want to protect their jobs.

There is no answerability on the part of management today unless someone like me comes along and really starts fighting. And it's really quite difficult. That's why not too many people do it.

Why do you think American management is so poor?

I keep saying I'm going to write a book called, "In Search of Mediocrity." Very often the fellow who runs American business today is the guy in college who was the head of your fraternity, a nice guy, someone you'd like to go drinking with, and you voted for him to be head of your fraternity because you really didn't care that much. Your fraternity wasn't your investment; it wasn't your life. A good drinking buddy, a lot of fun, and that's what you've got in American business.

Too many boards of directors really think of their companies as fraternities. They elect the guy the chairman wants. What goes on in the boardroom is a travesty. And the chairman doesn't want someone under him who is a threat. So he picks someone a little less capable. It's like an anti-Darwinian theory—the survival of the unfittest. And it's getting worse.

Aren't you over-dramatizing? There are a lot of good corporate managers who are doing an honest, decent job.

Yes, there are. And their stocks reflect it. When a company is doing a good job, nobody like me will come along because they don't come cheap. A company's stock price is like a report card. The guys who do a

good job get a good report card. That's true in 95 percent of the cases. There's a reason for a company to be selling cheaper than it's worth.

The restructuring is going on in the companies that are laggards. And I say they are laggards for a reason. Every company isn't under attack or under siege. There are companies that aren't worried and whose stocks are fairly priced. If the stock is cheap, it means the shareholders don't trust the management.

But some people won't take over a company unless there is good management in place, because they want them to run it.

Those are the leveraged buyout types, and I'm not in that business. I'm not completely anti-management. Maybe the management is pretty good and they've been constrained for certain reasons. A company may be better off in private hands than in public hands. There is no law that says Main Street must own America.

I've always felt that for a lot of people it's wrong to own common stocks. They should be in mutual funds. Let the funds make more of a contribution to keeping management on its toes. There should be answerability to those funds. You could have equity takeover funds, although they can't be too big because you wouldn't want the funds to own America. The funds would have someone sit on the board of a company—like they did in the days of the Guggenheims, the Rockefellers, the Morgans. They didn't run the companies but they had a guy on there, and those were good companies by and large.

How do you feel about conglomerates?

I'm not for or against conglomerates per se. But if you have a lot of divisions being poorly run by bad managers, why not split them up? There's good reason to reshuffle them, especially if you're not getting an adequate return on them. It's a good thing if you add to productivity. Adding to productivity corrects a lot of problems in this country. One of the major problems we always have is inflation. We've stopped it now for a while but at the cost of tight money and high deficits. If you increase productivity, this cures a lot of evils. You get that productivity by having your assets be more productive for you. And you get that from proper management.

How do you feel about the heavy debt burden that some companies are carrying?

I agree that to some extent there is too much debt against equity. But one of the reasons for that is not the leveraged buyout phe-

nomenon, because that's relatively small. The real reason corporations have to go for debt rather than equity is because their stocks sell too low. And the reason their stocks sell too low is that the market doesn't trust them anymore. That's because the whole capital-raising mechanism is reflecting the fact that the American shareholder doesn't trust the corporation anymore and would rather have debt than equity. So the real problem doesn't lie in the leveraged buyout, but in the fact that we are overburdened with debt on our balance sheets because corporations cannot raise equity as well as debt. The companies themselves realize that their stocks aren't selling too well in relation to value and they don't want to bring out more equity at these levels. This is the real problem. We can solve it if we let more takeovers come about, since this brings more equity into the picture.

How do you perceive a company as undervalued?

You look at the cash flow it's producing, or could produce, or has produced, relative to the price of the stock. That's oversimplified, of course. You look at a lot of other things as well. But the stock price is the report card, and management produces the report card. If the stock is cheap, it means the shareholders don't trust the management. They may argue that this isn't fair. There could be other reasons. But then you look at other stocks in the same group, or other companies in the same area, and you have to ask how come they're not cheap.

You have been accused of being a destroyer and not a creator.

I can't understand the criticism, because I don't destroy anything. When you buy a company and sell off the divisions, you don't destroy it; especially when somebody buys them and does even better with them than the previous management. I believe that if there had been this takeover activity ten or fifteen years ago, we wouldn't have the trouble we have with the steel industry. The whole rust belt wouldn't exist. But it does exist, because you couldn't go after the steel companies.

What makes you think that would have made a difference?

One of the great problems you had in the whole steel industry, and in the railroads, was poor management. If you had had answerability and someone could have gone after those steel companies, they would have done a lot of things differently. They would have expanded differently, they would have made different labor contracts, different labor concessions. The great irony is that the critics of the takeovers say you put a lot of people out of work. Number one, you don't put a lot of people out of work, but it would be better to put some people out of work now than a whole industry later. In steel, in railroads, even in automobiles, we paid great prices not to upset the apple cart.

Will this movement make American business more efficient?

Definitely. Even some of the guys who were against me and fought me so hard now admit that they're doing things they should have been doing before.

Client List

Sense is widely read by management of leading corporations.

It identifies current business trends and vital issues that impact corporate communications strategy. It provides new insights into the complex subject of corporate image. And it aids management as they develop a position for their company.

The purpose of Sense is to keep its readers ahead of the times by sharing 40 years of experience with them.

Here are some of the companies with whom we have shared our experience over the years.

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Abex
Aetna Life & Casualty
Alexander & Alexander
Allen Group
Allied Corporation
Aluminum Company of America
American Broadcasting Companies
American Cyanamid
American Express
American National Insurance
AmeriTrust
Amsted Industries
Amtrak
Anheuser-Busch
A&P
Armco Steel
Arkwright-Boston Insurance
Ashland Oil
Atlanta Gas Light
BankCal
Bear Stearns
Belk
Bendix
Beneficial Corporation
Berkshire Knitting Mills
Berol
Bonanza
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Coca-Cola Company
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Eastern Savings Bank
Eaton
Emery Industries
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First City National Bank
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Firstier
First Jersey National Bank
First National Bank Jackson, MS
First Union
Fisher Foods
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Massey-Ferguson
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Mead Johnson
Mercantile Trust Company
Merchants National Bank
Metro-Goldwyn-Mayer
Midlantic Bank
Molson Breweries
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National Paper
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Ocean Spray Cranberries
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Petrofina
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PSFS
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Quaker Oats
Quanex
Rainier Bank
Ray-O-Vac
RCA
Republic Steel
Rexnord
Rolls Royce Motors
Rotan Mosle
Royal Bank of Canada
Royal Crown Companies
Rustler
Ryder System
Salomon Brothers
SCANA Corporation
C. Schmidt & Sons
Sears, Roebuck
ServiStar
Shop Rite Foods
Singer
Smith Barney
Smithkline
Sohio
Sunoco
Sperry & Hutchinson
Squibb
Stanray
St. Regis Paper
Stroehmann Brothers
Stroh Brewery
Julien J. Studley
Suburban Propane
Sunray DX Oil
Taco Tico
Tambrands
Taylor California Cellars Wine
Tenneco
Textron
Texas Eastern Corporation
Toledo Edison
Tropicana Products
Uccel Corporation
Unifirst Federal Savings & Loan Association
Union Carbide
Union Mutual
Uniroyal
United States Gypsum
United States Steel
United Technologies
United Van Lines
United Virginia Bankshares
Unocal
Verex
Waldbaum's
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Name

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Company

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Lippincott & Margulies Ltd
London

Consultants in Communications
Marketing and Design:
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Corporate Identity Program Development
Corporate and Brand Name Development
Nomenclature Systems
Corporate Design Development
Corporate Design Systems
Brand Identity Development and Packaging
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